

# Individual Debt Adjustment Bankruptcy - Chapter 13

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## Background

Chapter 13 is designed for individuals with regular income who desire to pay their debts but are currently unable to do so. The purpose of chapter 13 is to enable financially distressed individual debtors, under court supervision and protection, to propose and carry out a repayment plan under which creditors are paid over an extended period of time. Under this chapter, debtors are permitted to repay creditors, in full or in part, in installments over a three-year period, during which time creditors are prohibited from starting or continuing collection efforts. A plan providing for payments over more than three years must be "for cause" and be approved by the court. In no case may a plan provide for payments over a period longer than five years. 11 U.S.C. § 1322(d).

Any individual, even if self-employed or operating an unincorporated business, is eligible for chapter 13 relief as long as the individual's unsecured debts are less than \$269,250 and secured debts are less than \$807,750. 11 U.S.C. § 109(e). A corporation or partnership may not be a chapter 13 debtor. Id.

An individual cannot file under chapter 13 or any other chapter if, during the preceding 180 days, a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court or was voluntarily dismissed after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. 11 U.S.C. §§ 109(g), 362(d) and (e).

## How Chapter 13 Works

A chapter 13 case begins with the filing of a petition with the bankruptcy court serving the area where the debtor has a domicile or residence. Unless the court orders otherwise, the debtor also shall file with the court (1) schedules of assets and liabilities, (2) a schedule of current income and expenditures, (3) a schedule of executory contracts and unexpired leases, and (4) a statement of financial affairs. Bankruptcy Rule 1007(b). A husband and wife may file a joint petition or individual petitions. 11 U.S.C. § 302(a). (Official Bankruptcy Forms can be purchased at a legal stationery store. They are not available from the court.)

Currently, the courts are required to charge a \$155 case filing fee and a \$30 miscellaneous administrative fee. The fees should be paid to the clerk of the court upon filing or may, with the court's permission, be paid in installments. 28 U.S.C. § 1930(a); Bankruptcy Rule 1006(b); Bankruptcy Court Miscellaneous Fee Schedule, Item 8. Rule 1006(b) limits to four the number of installments for the filing fee. The final installment shall be payable not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided that the last installment is paid not later than 180 days after the filing of the petition. Bankruptcy Rule 1006(b). If a joint petition is filed, only one filing fee and one administrative fee are charged.

In order to complete the Official Bankruptcy Forms which make up the petition, statement of financial affairs, and schedules, the debtor will need to compile the following information:

1. A list of all creditors and the amounts and nature of their claims;
2. The source, amount, and frequency of the debtor's income;
3. A list of all of the debtor's property; and
4. A detailed list of the debtor's monthly living expenses, i.e., food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

When a husband and wife file a joint petition or each spouse files an individual petition, the above detailed data must be gathered for both spouses. So that financial responsibilities can be accurately assessed when only one spouse files, the income and expenses of the non-filing spouse should be included in the debtor's schedules and statement of financial affairs.

Upon the filing of the petition, an impartial trustee is appointed to administer the case. 11 U.S.C. § 1302. If the number of cases so warrants, the United States trustee may appoint a standing trustee to serve in all chapter 13 cases in a district. 28 U.S.C. § 586(b). A primary role of the chapter 13 trustee is to serve as a disbursing agent, collecting payments from debtors and making distributions to creditors. 11 U.S.C. § 1302.

The filing of the petition under chapter 13 "automatically stays" most collection actions against the debtor or the debtor's property. 11 U.S.C. § 362. As long as the "stay" is in effect, creditors generally cannot initiate or continue any lawsuits, wage garnishment, or even telephone calls demanding payments. Creditors receive notice of the filing of the petition from the clerk or the trustee. Further, chapter 13 contains a special automatic stay provision applicable to creditors. Specifically, after the commencement of a chapter 13 case, unless the bankruptcy court authorizes otherwise, a creditor may not seek to collect a "consumer debt" from any individual who is liable with the debtor. 11 U.S.C. § 1301. Consumer debts are those incurred for consumer, as opposed to business, needs.

By virtue of the automatic stay, an individual debtor faced with a threatened foreclosure of the mortgage on his or her principal residence can prevent an immediate foreclosure by filing a chapter 13 petition. Chapter 13 then affords the debtor a right to cure defaults on long-term home mortgage debts by bringing the payments current over a reasonable period of time. The debtor is permitted to cure a default with respect to a lien on the debtor's principal residence up until the completion of a foreclosure sale under state law. 11 U.S.C. § 1322(c).

The debtor must file a plan of repayment with the petition or within fifteen days thereafter, unless extended by the court for cause. Bankruptcy Rule 3015. The chapter 13 plan must provide for the full payment of all claims entitled to priority under section 507<sup>1</sup> (unless the holder of a particular claim agrees to different treatment of the claim); if the plan classifies claims, provide the same treatment for each claim within each class; and provide for the submission of such portion of the debtor's future income to the supervision of the trustee as is necessary for the execution of the plan. 11 U.S.C. § 1322. Other plan provisions are permissive. Id. Plans, which must be approved by the court, provide for payments of fixed amounts to the trustee on a regular basis, typically biweekly or monthly. The trustee then distributes the funds to creditors according to the terms of the plan, which may offer creditors less than full payment on their claims. If the trustee or a creditor with an unsecured claim<sup>2</sup> objects to confirmation of the plan, the debtor is obligated to pay the amount of the claim or commit to the proposed plan all projected "disposable income" during the period in which the plan is in effect. 11 U.S.C. § 1325(b). Disposable income is defined as income not reasonably necessary for the maintenance or support of the debtor or dependents. If the debtor operates a business, disposable income is defined as excluding those amounts which are necessary for the payment of ordinary operating expenses. 11 U.S.C. § 1325(b)(2)(A) and (B).

A meeting of creditors is held in every case, during which the debtor is examined under oath. It is usually held 20 to 50 days after the petition is filed. If the United States trustee or bankruptcy administrator<sup>3</sup> designates a place for the meeting which is not regularly staffed by the United States trustee or bankruptcy administrator, the meeting may be held no more than 60 days after the order for relief. Bankruptcy Rule 2003(a). The debtor must attend the meeting, at which creditors may appear and ask questions regarding the debtor's financial affairs and the proposed terms of the plan. 11 U.S.C. § 343. If a husband and wife have filed a joint petition, both must attend the

creditors' meeting.) The trustee will also attend the meeting and question the debtor on the same matters. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending. 11 U.S.C. § 341(c). If there are problems with the plan, they are typically resolved during or shortly after the creditors' meeting. Generally, problems may be avoided if the petition and plan are complete and accurate and the trustee has been consulted prior to the meeting.

In a chapter 13 case, unsecured creditors who have claims against the debtor must file their claims with the court within 90 days after the first date set for the meeting of creditors. Bankruptcy Rule 3002(c). A governmental unit, however, may file a proof of claim until the expiration of 180 days from the date the case is filed. 11 U.S.C. § 502(b)(9).

After the meeting of creditors is concluded, the bankruptcy judge must determine at a confirmation hearing whether the plan is feasible and meets the standards for confirmation set forth in the Bankruptcy Code. 11 U.S.C. §§ 1324 and 1325. Creditors, who will receive 25 days' notice of the hearing, may object to confirmation. While a variety of objections may be made, the most frequent ones are that payments offered under the plan are less than creditors would receive if the debtor's assets were liquidated or that the debtor's plan does not commit all of the debtor's projected disposable income for the three-year period of the plan.

Within thirty days after the filing of the plan, even if the plan has not yet been approved by the court, the debtor must start making payments to the trustee. 11 U.S.C. § 1326(a)(1). If the plan is confirmed by the bankruptcy judge, the chapter 13 trustee commences distribution of the funds received in accordance with the plan "as soon as practicable." 11 U.S.C. § 1326(a)(2). If the plan is not confirmed, the debtor has a right to file a modified plan. 11 U.S.C. § 1323. The debtor also has a right to convert the case to a liquidation case under chapter 7. 11 U.S.C. § 1307. If the plan or modified plan is not confirmed and the case is dismissed, the court may authorize the trustee to retain a specified amount for costs, but all other funds paid to the trustee are returned to the debtor. 11 U.S.C. § 1326(a)(2).

On occasion, changed circumstances will affect a debtor's ability to make plan payments, a creditor may object or threaten to object to a plan, or a debtor may inadvertently have failed to list all creditors. In such instances, the plan may be modified either before or after confirmation. 11 U.S.C. §§ 1323 & 1329. Modification after confirmation is not limited to an initiative by the debtor, but may be at the request of the trustee or an unsecured creditor. 11 U.S.C. § 1329(a).

## **Making the Plan Work**

The provisions of a confirmed plan are binding on the debtor and each creditor. 11 U.S.C. § 1327. Once the court confirms the plan, it is the responsibility of the debtor to make the plan succeed. The debtor must make regular payments to the trustee, which will require adjustment to living on a fixed budget for a prolonged period. Alternatively, the debtor's employer can withhold the amount of the payment from the debtor's paycheck and transmit it to the chapter 13 trustee. Furthermore, while confirmation of the plan entitles the debtor to retain property as long as payments are made, the debtor may not incur any significant new credit obligations without consulting the trustee, as such credit obligations may have an impact upon the execution of the plan. 11 U.S.C. §§ 1305(c), 1322(a)(1) & 1327.

A debtor may consent to the deduction of the plan payments from the debtor's paycheck. Experience has shown that this practice increases the likelihood that payments will be made on time and that the plan will be completed. In any event, failure to make the payments in accordance with the confirmed plan may result in dismissal of the case or its conversion to a liquidation case under chapter 7 of the Bankruptcy Code. 11 U.S.C. § 1307(c).

## **The Chapter 13 Discharge**

The bankruptcy law regarding the scope of the chapter 13 discharge is complex and has recently undergone major changes. Therefore, debtors should consult competent legal counsel prior to filing regarding the scope of the chapter 13 discharge.

The chapter 13 debtor is entitled to a discharge upon successful completion of all payments under the chapter 13 plan. 11 U.S.C. § 1328(a). The discharge has the effect of releasing the debtor from all debts provided for by the

plan or disallowed (under section 502), with limited exceptions. Those creditors who were provided for in full or in part under the chapter 13 plan may no longer initiate or continue any legal or other action against the debtor to collect the discharged obligations.

In return for the willingness of the chapter 13 debtor to undergo the discipline of a repayment plan for three to five years, a broader discharge is available under chapter 13 than in a chapter 7 case. As a general rule, the debtor is discharged from all debts provided for by the plan or disallowed, except certain long term obligations (such as a home mortgage), debts for alimony or child support, debts for most government funded or guaranteed educational loans or benefit overpayments, debts arising from death or personal injury caused by driving while intoxicated or under the influence of drugs, and debts for restitution or a criminal fine included in a sentence on the debtor's conviction of a crime. 11 U.S.C. § 1328(a). To the extent that these types of debts are not fully paid pursuant to the chapter 13 plan, the debtor will still be responsible for these debts after the bankruptcy case has concluded.

## **The Chapter 13 Hardship Discharge**

After confirmation of a plan, there are limited circumstances under which the debtor may request the court to grant a "hardship discharge" even though the debtor has failed to complete plan payments. 11 U.S.C. § 1328(b). Generally, such a discharge is available only to a debtor whose failure to complete plan payments is due to circumstances beyond the debtor's control and through no fault of the debtor, after creditors have received at least as much as they would have received in a chapter 7 liquidation case and when modification of the plan is not possible. Injury or illness that precludes employment sufficient to fund even a modified plan may serve as the basis for a hardship discharge. The hardship discharge is more limited than the discharge described above and does not apply to any debts that are nondischargeable in a chapter 7 case. 11 U.S.C. § 523.

### **NOTES**

1. Section 507 sets forth nine categories of unsecured claims which Congress has, for public policy reasons, given priority of distribution over other unsecured claims.
2. Unsecured debts generally may be defined as those for which the extension of credit was based purely upon an evaluation by the creditor of the debtor's ability to pay. In contrast, secured debts are those for which the extension of credit was based upon not only the creditor's evaluation of the debtor's ability to pay, but upon the creditor's right to seize pledged property on default.
3. Bankruptcy Administrators, rather than U.S. trustees, serve in the judicial districts in the states of Alabama and North Carolina.